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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

July 21, 1998

EX PARTE OR LATE FILED

**Magalie Roman Salas
Secretary
Federal Communications Commission
Washington DC 20554**

Re: EX PARTE in Universal Service Reform, CC Docket No. 96-45

Dear Ms. Salas:

On July 20, 1998, Jonathan B. Sallet, MCI's Chief Policy Counsel, Michael Pelcovits, MCI's Chief Economist, Neal Larsen, and Joseph Miller met with Chairman Pat Wood of the Texas Commission and Federal-State Joint Board to discuss pending issues in the above-captioned proceeding.

Attached is material that MCI used in its presentation to Mr. Wood.

Sincerely,

Mary L. Brown

CC: Pat Wood

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UNIVERSAL SERVICE REFORM

Universal Service Cannot Be Fixed By Itself...

- ◆ It must be implemented in a fashion that fosters local competition.
- ◆ It must be implemented with dollar for dollar reductions in access charges.
- ◆ All parts must be based on forward-looking economic cost.

Principles

- ◆ The subsidy should be the **minimum** needed to meet the public-policy objective of affordability.
 - It should be **targeted to high-cost areas** in states.
 - It should be calculated by comparing the **forward-looking economic cost** of providing service to the per-line revenues that would be generated when rates for basic service are affordable (a nationwide affordability benchmark).
 - A small interstate fund does not yield a minimum subsidy if implicit subsidies are not reduced or if accompanied by an inflated intrastate fund.

Principles

- ◆ For every dollar of explicit subsidy collected, there must be a dollar **reduction in implicit subsidies** currently borne by the customers/providers paying into the new explicit fund.
- ◆ The funding mechanism should be implemented, and the subsidy dispersed, in a **competitively-neutral and administratively efficient fashion** consistent with the pro-competition provisions and spirit of the Telecommunications Act.
 - The mechanism should foster interconnection and access reform, e.g., by tying funding for non-rural LECs to the opening of local markets.
 - Providers should be allowed to recover Universal Service funds through end user charges.

MCI'S PROPOSAL

The MCI proposal for non-rural LECs provides one way to meet these sound public policy principles. It can be applied to any interstate fund, without regard to the percentage of Universal Service subsidy burden borne by the interstate jurisdiction.

- ◆ Determine the size of the interstate fund by comparing the affordability revenue benchmark to the forward-looking economic costs of providing service, calculated using the same cost zones as the state uses for setting deaveraged loop rates.
- ◆ Calculate the share borne by each interstate service provider by multiplying the total subsidy needed by the carrier's share of retail interstate revenues.

MCI'S PROPOSAL

- ◆ Do not allow the LECs to recover the assessment on their retail interstate services from their wholesale customers through the inclusion of these costs in access charges.
- ◆ Encourage all contributors to identify the Universal Service assessment on customer bills as a federal Universal Service fee.
- ◆ The dollar reduction in implicit interstate subsidies for every dollar collected by the explicit Universal Service fund would be accomplished in the following order:
 - Pay off the additional interstate revenue requirement allocation made under Rule 36.631
 - Reduce interstate access charges, starting with the CCLC, then, if needed, the PICC, and then, if needed, the local switching charge.
- ◆ Since national funding is from interstate revenues only, any state Universal Service fund must be imposed only on intrastate revenues.

Link Explicit USF Subsidies to Unbundled Loop Rate Deaveraging

- ◆ Universal Service subsidy calculations should be tied to the degree of unbundled loop rate deaveraging in the ILEC's service area.
- ◆ This approach will create a virtuous cycle of pro-competitive action by giving ILECs and states the incentive to deaverage loop rates into zones that reflect underlying cost differences.
- ◆ Until loop rates are deaveraged, there is no compelling need for new explicit funding.
- ◆ Once loop rates are deaveraged, the presence of the new explicit funds will ensure that competition and support for high-cost areas go hand in hand, which is the best way to expand universal service.

Universal Service Calculation Sheet

monthly costs per line

HAI Model

Texas

Southwestern Bell-Texas

	0 - 5	5 - 100	100 - 200	200 - 650	650 - 850	850 - 2,550	2,550 - 5,000	5,000 - 10,000	> 10,000	Weighted Average
	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	lines/sq mi	
Costs										
Loop	\$ 129.37	\$ 36.93	\$ 19.23	\$ 14.55	\$ 11.99	\$ 9.82	\$ 8.18	\$ 7.28	\$ 5.13	\$ 12.06
Other	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88	\$ 2.88
Avg monthly cost per line	\$ 132.25	\$ 39.81	\$ 22.11	\$ 17.43	\$ 14.87	\$ 12.70	\$ 11.06	\$ 10.16	\$ 5.13	\$ 14.94
Revenue per month										
Residential	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00	\$ 31.00
Business	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00
Total switched lines	69,820	548,992	232,808	807,450	258,241	2,375,516	2,489,688	1,119,377	740,271	8,612,162
Residence lines	65,643	464,235	178,253	551,727	189,059	1,879,490	1,639,304	622,531	264,047	5,854,289
Business & Public lines	4,177	84,757	54,555	255,723	69,182	696,026	850,384	496,846	476,224	2,957,873
Total Annual Support	\$ 73,136,425.00	\$ 52,044,387.00								

Total support
with deaveraging \$ 125,180,812.00

Total support
without deaveraging \$

July 20, 1998

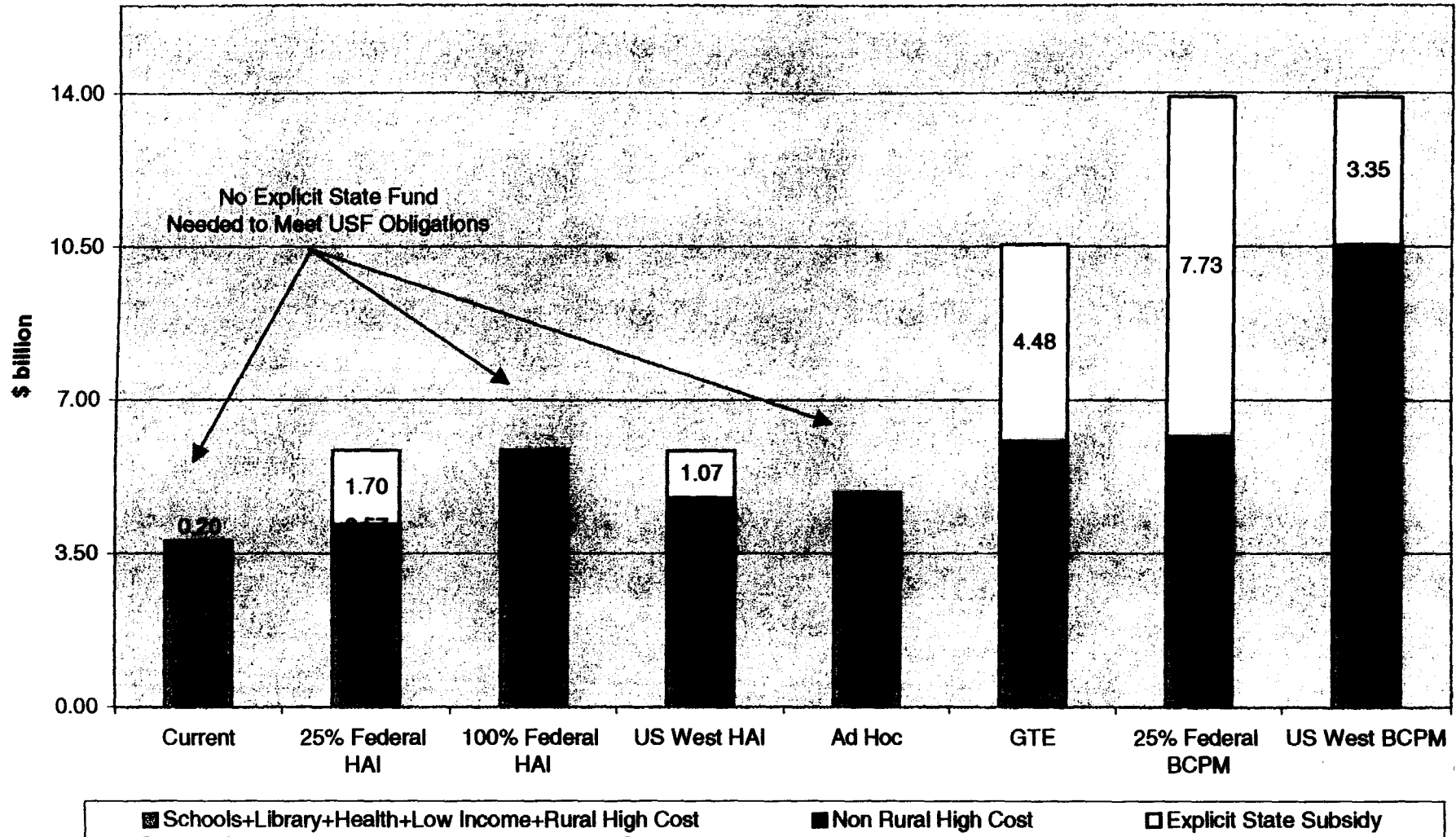
How the Various Universal Service Proposals Meet Sound Public Policy Principles



Principle	Proposal Meets the Principle	Proposal Does Not Meet the Principle	Proposal Does Not Address Principle
Subsidy is minimum needed to meet the public policy objective of affordability: small interstate fund does not yield minimum subsidy if implicit subsidies not reduced or if accompanied by inflated intrastate fund.	MCI, Ameritech, CFA	Ad Hoc, Arizona, BellSouth, GTE, Sprint, U S West	AT&T, Colorado, Time Warner
For every \$ of explicit subsidy collected, \$ reduction in implicit subsidies currently borne by those paying into the new explicit fund.	MCI, Ameritech, BellSouth, Sprint	Ad Hoc, Arizona, CFA, GTE, U S West	AT&T, Colorado, Time Warner
Funding burden imposed, and subsidy dispersed, in a competitively neutral and administratively efficient fashion.	MCI, Ameritech, CFA, GTE, Sprint	Ad Hoc, Colorado, Time Warner, U S West	Arizona, AT&T, BellSouth, CFA, Colorado
Consistent with pro-competition provisions and spirit of the Act — fosters interconnection and access reform: high cost Universal Service funding for non-rural LECs tied to opening of local markets.	MCI, AT&T	Ad Hoc, Arizona, BellSouth, CFA, Colorado, GTE, Sprint, U S West	Ameritech, Time Warner

Note: Many of the proposals submitted did not provide detail on how the funding burden would be imposed, how the subsidy would be dispersed, or other information needed to fully analyze whether the funding mechanism would be administratively efficient.

Explicit USF
Current USF Compared to USF Proposals
(Excludes Puerto Rico)



Texas

	Explicit Federal Subsidy (\$ million)	Change in Non Rural Receipts (\$ million)
Current	120.52	0.00
25% Federal HAI	149.52	29.00
100% Federal HAI	312.36	191.83
USW HAI	327.65	107.13
Ad Hoc	153.69	43.16
GTE	828.19	707.66
25% Federal BCPM	342.41	221.88
USW BCPM	828.19	707.66

THE STATES' ISSUES

- Q) Whether the FCC should take responsibility only for 25% of the high cost subsidy.
- A) The fund could go above 25% if interstate access charges are reduced by the amount of explicit subsidy and federal funding is tied to competition.
- Q) Whether federal universal service funds should reduce the cost of interstate access charges.
- A) Interstate access charges should be reduced by the amount of the explicit subsidy.
- The FCC has found that part of interstate access charges support universal service. With the creation of an explicit subsidy, these implicit subsidies must be removed.
 - Some rate must be reduced or else LECs would double-dip.
 - Interstate rates must be reduced to prevent a separations change.
 - Interstate rates should be reduced because customers of interstate services will be paying the explicit high cost fund amounts.
- Q) What method should be used for formulating and distributing high cost funds among the States.
- A) Under MCI's proposal, states would get, at a minimum, their current level of support. States could receive more support when loop rates are deaveraged.

THE STATES' ISSUES

- Q) Whether and to what extent the FCC should have a role in making intrastate support systems explicit, and a referral of the section 254(k) issue concerning recovery of joint and common costs.
- A) The Telecommunications Act requires universal service subsidies, in both the state and federal jurisdictions, to be explicit.
- Q) The revenue base upon which the FCC should assess and recover providers' contributions for universal service.
- A) If the federal Fund is assessed on interstate and international revenues only, then state funds must be imposed only on intrastate revenues.
- Q) Whether, to what extent, and in what manner providers should recover contributions to universal service through their rates.
- A) Providers are entitled to recover all of their universal service costs.
- Providers should recover universal service costs from their customers through explicit charges.
 - Providers should recover universal service costs in the same manner as they are assessed.